

## Message Text

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E.O. 11652: N/A

TAGS: ECON, EFIN, OECD, CA, ETRD

SUBJECT: EDRC ANNUAL REVIEW OF CANADIAN ECONOMY

REF: PARIS OECD 30838

1. WE IN GENERAL AGREEMENT WITH MAIN POINTS SECRETARIAT DRAFT SURVEY OF CANADIAN ECONOMY. ANALYSIS OF INFLATION THROUGH RECENT BUSINESS CYCLES SEEMS PARTICULARLY THOUGHTFUL AND PLACES PROBLEM OF POLICY OPTIONS IN A PERSPECTIVE NOT NORMALLY SEEN HERE. IF DEPT. CONCURS, WE SUGGEST USDEL CONSIDER FOLLOWING POINTS, ARISING FROM PERTINENT PARAGRAPHS SECRETARIAT DOCUMENT, IN ITS DISCUSSION OF GOC POLICIES.

2. THERE LITTLE DOUBT THAT BRISK EXPANSION AND REAL GROWTH THAT CHARACTERIZED ECONOMY THROUGH EARLY 1973 IN LARGE PART A PRODUCT OF GOC DEMAND MANAGEMENT POLICIES. SECOND AND THIRD QUARTER RESULTS, HOWEVER, (REAL GROWTH OF 0.7 PERCENT AND 0.4 PERCENT RESPECTIVELY) UNDERSCORE FACT THAT ECONOMY OPERATING BEYOND LONG-TERM CAPACITY AND EXPERIENCING SHORTAGES IN MATERIALS AND  
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LABOR SKILLS. EXPANSION IN 1974 CLOSELY LINKED TO SURGE IN OVERALL NEW BUSINESS FIXED INVESTMENT (PARA 32) NOW ESTIMATED AT 21 PERCENT ACCORDING TO RECENT DEPT. INDUSTRY, TRADE AND COMMERCE SURVEY. SAME SURVEY

INDICATES INVESTMENT IN MANUFACTURING SECTOR WILL RISE BY 47 PERCENT. COMBINATION OF WIDESPREAD SHORTAGES, ENERGY CRISES WITH EXPECTED LOWER GROWTH RATES IN U.S. AND BEARISH STOCK MARKET (TORONTO INDUSTRIAL INDEX DECLINED 18 PERCENT IN SIX WEEKS ENDING LAST WEEK FOR LARGEST SHORT PERIOD DROP SINCE 1929) COULD LEAD TO SIGNIFICANT SHORTFALL IN INVESTMENT EXPANSION. GOC VIEWS ON HOW IT PLANS INSURE CONTINUED HIGH RATES OF GROWTH IN FACE EMERGING SHORTAGES--IMPLYING A POLICY SHIFT FROM DEMAND TO SUPPLY MANAGEMENT--WOULD BE OF INTEREST.

3. REFERENCE TO "CLEAR EVIDENCE OF INCREASED STRUCTURAL AND REGIONAL IMBALANCES " (PARA 15) SUGGESTS FAILURE OF POLICIES TO REDRESS REGIONAL DISPARITIES. THIS IN PART RECOGNIZED WITH REORGANIZATION AND DECENTRALIZATION OF DEPT. OF REGIONAL ECONOMIC EXPANSION WITH INTRAGOVERNMENTAL TRANSFERS (MOSTLY EQUALIZATION PAYMENTS TO LESSER DEVELOPED PROVINCES) RISING FROM 6.9 PERCENT TO 10.9 PERCENT OF GNP IN PAST TEN YEARS (TABLE 7) LACK OF PROGRESS IN REDUCING REGIONAL DIFFERENCES SUGGESTS NEED FOR ADDITIONAL PROGRAMS. GOC PLANS -- BEYOND DREE# REORGANIZATION-- IN THIS REGARD WOULD BE OF INTEREST.

4. SOLID EVIDENCE OF HIGHER LABOR COSTS IN TIME OF DECLINING PRODUCTIVITY (PARA 17) AND BEGINNING OF NEW ROUND OF THREE-YEAR WAGE SETTLEMENTS (PARA 18) SUGGESTS EVEN GREATER INFLATIONARY PRESSURES FROM THIS SECTOR IN 1974 THAT AN INCOMES POLICY MIGHT AVERT. SECRETARIAT ALLUDES TO NEED FOR COMPREHENSIVE INCOMES POLICY THROUGHOUT DOCUMENT AND WE BELIEVE AN EXPLICIT DISCUSSION OF THIS SUBJECT WOULD BE BENEFICIAL. GOC HAS DOWNPLAYED NEED FOR WAGE AND PRICE CONTROLS OR GUIDELINES WITH COMMENTS THAT SITUATION NOT SERIOUS ENOUGH TO CONSIDER THEM AND THAT THE PUBLIC SUPPORT NECESSARY TO SUCCESSFUL IMPLEMENTATION OF CONTROLS NOT LIMITED OFFICIAL USE  
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YET PRESENT. IF INCOMES POLICY NOT CONSIDERED DESIREABLE OR FEASIBLE, USDEL MIGHT POINT TO SECRETARIAT COMMENT REGARDING LACK OF COMPREHENSIVE STRATEGY TO DEAL WITH INFLATION (PARA 40) AND SEEK GOC IDEAS AS TO ALTERNATIVES. SUGGESTION FOR WIDE RANGING CONSULTATIONS (PARA 43) ON ECONOMIC POLICY WERE MADE BY ECONOMIC COUNCIL OF CANADA IN ITS ECONOMIC REVIEW OF 1972 AND 1973, GOC HAS ORGANIZED SEVERAL REGIONAL AND "MICROECONOMIC " FEDERA-PROVINCIAL CONFERENCES (COMMUNICATIONS, HEALTH, ENERGY, ETC.) BUT NONE THAT TAKE IN ALL SECTORS THAT COULD FORM BASIS FOR COMPREHENSIVE POLICIES DEALING WITH GROWING INFLATIONARY

PSYCHOLOGY (PARA 41) OR SUPPLY PROBLEMS.

5. DISCUSSION OF RECENT MONETARY POLICY (PARA 27)  
INDICATES THAT EXCHANGE RATE CONSIDERATIONS HAVE BEEN  
INFLUENTIAL. GOC COMMENTS ON EXTENT TO WHICH THESE  
CONSIDERATIONS WERE RESPONSIBLE FOR HIGHLY EXPANSIONARY POLICIES  
WOULD BE USEFUL IN EVALUATING PREVIOUS GOC  
REMARKS CONCERNING EXCHANGE MARKET INTERVENTION AND  
"CLEAN" FLOAT. POSSIBLE REQUIREMENT FOR CONTINUED  
TIGHTENING OF MONETARY POLICY FOR DOMESTIC REASONS IN  
1974 AT TIME U.S. INTEREST RATES MAY MOVE DOWN TO  
COUNTER ENERGY CRISIS-FOSTERED SLOWDOWN RAISES QUESTION  
OF EXTENT TO WHICH GOC WILL PERMIT DIFFERENTIAL TO PUSH  
UP CANADIAN DOLLAR WHICH NOW TWO PERCENT BELOW 1972  
HIGH. QUESTION IS BASICALLY ONE OF TRULY INDEPENDENT  
MONETARY POLICY--NOT YET FULLY ANSWERED BY GOC.

6. WHILE THERE HAVE BEEN SOME REDUCTIONS IN IMPORT  
DUTIES AND EXPORT CONTROLS TO REDUCE PRICE PRESSURES  
(PARA 26), RECENTLY IMPOSED BEEF SURTAXES (PARA 26,  
FOOTNOTE 3) WORK IN THE OTHER DIRECTION. WE  
UNDERSTAND SOME FRUIT AND VEGETABLE TARIFFS ARE BEING  
REVIEWED WITH SUGGESTION THEY MAY BE INCREASED AGAIN.  
GOC COMMENTS ON POLICY APPROACH THESE ITEMS AND  
IMPLICATIONS FOR ADDITIONAL INFLATIONARY PRESSURES  
WOULD BE USEFUL.

7. DISCUSSION OF ACCELERATION OF INFLATION (PARA 4)  
CAN BE MADE MORE CURRENT WITH INCLUSION NOVEMBER  
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CONSUMER PRICE INDEX DATA RELEASED DECEMBER 11 SHOWING  
THAT ALL ITEMS (SEASONALLY ADJUSTED) INCREASED BY  
0.8 PERCENT TO 155.5 OR 9.3 PERCENT ABOVE NOVEMBER  
972. FOOD INDEX ROSE BY 1.2 PERCENT DURING MONTH TO  
171.8 OR 18.4 PERCENT ABOVE NOVEMBER 1972. RATE OF  
INCREASE HAS ACCELERATED IN VIRTUALLY EVERY MONTH OF  
THE YEAR. DOMESTIC OIL PRICE FREEZE (PARA 26) HAS  
BEEN EXTENDED THROUGH WINTER AND MAY HAVE SOME  
DAMPENING EFFECT ON PRICE RISES IN THIS PERIOD.  
SEASONALLY ADJUSTED UNEMPLOYMENT DATA FOR NOVEMBER,  
ALSO RELEASED DECEMBER 11, REFLECT MARGINAL  
IMPROVEMENT WITH A DECLINE FROM 5.8 PERCENT IN  
OCTOBER TO 5.6 PERCENT IN NOVEMBER.

8. WHILE WE LACK SUFFICIENT DATA TO PROJECT BALANCE  
OF PAYMENTS RESULTS FOR 1974, WE NOT AS SANGUINE AS  
SECRETARIAT REGARDING POSSIBILITY OF ELIMINATING  
CURRENT ACCOUNT DEFICIT IN COMING YEAR (PARA 36). AS  
POINTED OUT IN PARA 9, CLOSE LINKS TO U.S. MAKE CANADA  
VULNERABLE TO EXTERNAL INFLUENCES, PERHAPS MORE SO THAN

STATED IN PARA 30. WHILE INCOME FROM SIGNIFICANTLY  
HIGHER PETROLEUM PRICES WILL OFFSET SOME DEGREE OF  
SLACK, POSSIBILITY OF SLOWER U.S. GROWTH RATE WILL  
AFFECT DEMAND FOR CANADIAN EXPORTS (70 PERCENT OF  
LATTER'S TRADE) EXPANSION OF WHICH MUST BE AT CENTER  
OF ANY CURRENT ACCOUNT IMPROVEMENT.  
JOHNSON

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